DEPARTMENT OF STATE REVENUE
LETTER OF FINDINGS NUMBER: 97-0284
Adjusted Gross Income Tax
For Tax Years 1992 through 1994

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ISSUE

I. Adjusted Gross Income Tax—Unitary (Combined) Filing Status

Authority: *Mobil Oil Corporation v. Commissioner of Taxes of Vermont*, 445 U.S. 425, 100 S.Ct. 1223 (1980); *Exxon Corp. v. Department of Revenue of Wisconsin*, 447 U.S. 207, 100 S.Ct. 2109 (1980); *ASARCO, Inc. v. Idaho State Tax Commission*, 458 U.S. 307, 102 S.Ct. 3103 (1982); *F.W. Woolworth v. Taxation and Revenue Department of New Mexico*, 458 U.S. 354, 102 S.Ct. 3128 (1982); *Allied-Signal, Inc. v. Director, Division of Taxation*, 504 U.S. 768, 112 S.Ct. 2251 (1992)
45 IAC 3.1-1-153(b), (c)

Taxpayer protests the Department's determination that taxpayer's subsidiary's distributive partnership share should have been classified as non-business income because the subsidiary did not enjoy a unitary relationship with a certain partnership in which it held a fifty percent (50%) partnership interest.

II. Adjusted Gross Income Tax—Net Operating Loss Deductions

Authority: Ind. Code § 6-3-2-2.6
26 USCA § 172
Treasury Regulation Section 1.172-4(a)(3)

Taxpayer protests the Department's application of taxpayer's net operating losses for the tax year ending 1993.

STATEMENT OF FACTS

At the time of the audit, taxpayer was an out-of-state corporation principally engaged in the exploration for, and the production, transportation, and sale of crude oil and natural gas in the United States and foreign countries; and, the manufacture, purchase, transportation and marketing of petroleum and selected chemical products. For federal income tax purposes, taxpayer filed

consolidated tax returns with its Parent and all of its wholly owned subsidiaries. Taxpayer's Parent acted as a holding company, and taxpayer acted as the operating parent.

For Indiana gross income and adjusted gross income tax purposes, taxpayer filed separate tax returns through tax year ending 1992. Beginning in tax year 1993, taxpayer began to file on a consolidated basis with its subsidiary (hereinafter, the "Subsidiary"). The Subsidiary was formed in 1989 for the purpose of holding a fifty percent (50%) interest in a partnership. The partnership was a refining and marketing joint-venture located in the Middle-West United States, which owned a refinery, product terminals, lubricant terminals, and a lube oil blending and packaging plant (hereinafter, the "Partnership"). The Subsidiary had no other sources of income other than its distributive share from its partnership interest.

The Department of Revenue conducted an audit for the years in question and determined that the Subsidiary did not enjoy a unitary relationship with the Partnership. As such, the Department determined that the Subsidiary's distributive share of partnership income should have been excluded from taxpayer's consolidated income and apportionment calculations and allocated to Indiana pursuant to 45 IAC 3.1-1-153(c).

Taxpayer declined to schedule an administrative hearing with the Department or send additional documentation in support of its argument. Therefore, the Department issues this Letter of Findings based on its best understanding of the facts as provided by the auditor and the taxpayer's original protest letter.

I. Adjusted Gross Income Tax—Unitary (Combined) Filing Status

DISCUSSION

Taxpayer argues that the Department erred in finding that taxpayer's Subsidiary did not enjoy a unitary relationship with the Partnership. The Department determined that the Subsidiary's corporate activities and the Partnership's activities did not constitute a unitary business under established standards because the Subsidiary was a holding company whose sole corporate activity was to hold a fifty percent (50%) interest in the Partnership.

45 IAC 3.1-1-153 specifically addresses the manner in which to treat a corporate partner with respect to partnership income. This regulation is also determinative of how to determine whether or not a unitary relationship exists. 45 IAC 3.1-1-153(b) reads in part that if a

> "corporate partner's activities and the partnership's activities constitute a unitary business under established standards, disregarding ownership requirements, the business income of the unitary business attributable to Indiana shall be determined by a three (3) factor formula consisting of property, payroll, and sales of the corporate partner and its share of the partnership's factors . . ."

(Alternatively, 45 IAC 3.1-1-153(c) sets forth the means by which one attributes partnership income in those situations where the corporate partner's activities and the partnership's activities *do not* demonstrate a unitary business relationship.) This section further indicates that to

establish the existence of a unitary operation, the taxpayer must demonstrate that the relationship itself and the partnership meet the established characteristics of a unitary relationship.

The Supreme Court over the years has developed a three-part test in determining whether a unitary relationship exists: common ownership, common management, and common use or operation. *See, e.g., Mobil Oil Corporation v. Commissioner of Taxes of Vermont*, 445 U.S. 425, 100 S.Ct. 1223 (1980); *Exxon Corp. v. Department of Revenue of Wisconsin*, 447 U.S. 207, 100 S.Ct. 2109 (1980); *ASARCO, Inc. v. Idaho State Tax Commission*, 458 U.S. 307, 102 S.Ct. 3103 (1982); *F.W. Woolworth v. Taxation and Revenue Department of New Mexico*, 458 U.S. 354, 102 S.Ct. 3128 (1982); *Allied-Signal, Inc. v. Director, Division of Taxation*, 504 U.S. 768, 112 S.Ct. 2251 (1992). To establish a unitary relationship, taxpayer must demonstrate at the very least that a corporate partner has operational control of the partnership or that management of the partnership is centralized with management of the corporation.

Here, the information in taxpayer's file shows that during the audit period, the Subsidiary held a fifty percent (50%) interest in the Partnership. The Subsidiary's only corporate activity was holding the interest in the Partnership. The Subsidiary performed no administrative or management functions for the Partnership. Given the appearance of the Subsidiary's limited role in the operations of the Partnership, taxpayer would have to show that the Subsidiary was given an unusual amount of control from the other partners to prove that the Subsidiary and the Partnership enjoyed a unitary relationship. Taxpayer submitted no evidence evincing that such control was given to taxpayer by the other partners. As taxpayer has failed to meet the first prong of the three-part test, taxpayer has failed to establish that it enjoyed a unitary relationship with the Partnership.

FINDING

Taxpayer's protest is denied.

II. Adjusted Gross Income Tax—Net Operating Loss Deductions

DISCUSSION

During the audit period, taxpayer carried forward certain net operating losses (NOLs) to reduce (or eliminate) its reportable Indiana adjusted gross income. The auditor determined that taxpayer had misapplied its NOL deduction for tax year ending 1993. The auditor further determined that the correct way to apply the NOL was to apply it first to taxpayer's positive Indiana allocated income for the tax year ending 1993, and then apply any residual amounts to the tax year ending 1994. Taxpayer protests the auditor's application.

Indiana treatment of net operating losses is governed by the provisions of the federal law concerning corporate net operating losses. IC 6-3-2-2.6. Pursuant to IC 6-3-2-2.6, Indiana allows a corporation or nonresident person to reduce their adjusted gross income tax with a deduction as allowed under the Internal Revenue Code (IRC) Section 172. Section 172 of the IRC states in part:

(a) Deduction Allowed -- There shall be allowed as a deduction for the taxable year an amount equal to the aggregate of (1) the net operating loss carryovers to such year, plus (2) the net operating loss carrybacks to such year. For purposes of this subtitle, the term "net operating loss deduction" means the deduction allowed by this subsection.

(b) Net Operating Loss Carrybacks and Carryovers—
(1) Years to Which Loss May Be Carried --
(A) General Rule - Except as otherwise provided in this paragraph, a net operating loss for any taxable year --
(i) shall be net operating loss carryback to each of the 3 taxable years preceding the taxable year of such loss, and
(ii) shall be net operating loss carryover to each of the 15 taxable years following the taxable year of the loss.

Treasury Regulation Section 1.172-4(a)(3) states that the loss carrybacks and carryovers "are considered to be applied in reduction of the taxable (or net) income in the order of the taxable years from which such losses are carried over or carried back, beginning with the loss for the earliest taxable year." In the instant case, the NOL should be carried back or forward to the applicable year and not applied to current income.

FINDING

Taxpayer's protest is sustained.

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